

FY 1997 and 1998 Intended Use Plan for set-aside

State of Michigan

John Engler, Governor

Department of Environmental Quality

Russell J. Harding, Director

INTERNET: <http://www.deq.state.mi.us>

Drinking Water Revolving Fund

Final Intended Use Plan for Set-Aside

Funds

Fiscal Year 1997/1998

Prepared by:

Municipal Facilities Section, Environmental Assistance Division
and Drinking Water and Radiological Protection Division

September, 1997

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I. INTRODUCTION

Governor John Engler has recently signed into law legislation designed to establish the **Drinking Water Revolving Fund (DWRF)** in Michigan. The laws, 1997 PA 26 and PA 27 were sponsored by State Representative Jon Jellema from the 89th District in Ottawa County. They establish the DWRF and designate that the Michigan Department of Environmental Quality (DEQ) and the Michigan Municipal Bond Authority (the Authority) will administer it. The DWRF provides low-interest loan financing to qualified water suppliers to construct and/or improve waterworks systems.

1997 PA 26 adds Part 54, Safe Drinking Water Assistance, to 1994 PA 451, Natural Resources and Environmental Protection Act. 1997 PA 27 amends 1985 PA 227, the Shared Credit Rating Act.

This fund is similar to, but separate from Michigan's **Clean Water Revolving Fund, or SRF**. This is an important distinction. The new DWRF allows the DEQ to apply to the U.S. Environmental Protection Agency (EPA) for capitalization grant funds. An application for a partial capitalization grant to secure special set-aside funds was prepared for submittal to the EPA by September 1, 1997. **This Intended Use Plan (IUP) is for set-aside funds only.** The timeline to apply for the remainder of the capitalization grants is tentatively set for late second quarter of Fiscal Year (FY) 1998. Funding for projects is expected to begin with third quarter loan closings next fiscal year.

While these two programs will run on parallel tracks, there will be differences in

schedules and requirements. It is imperative that interested parties work with DEQ staff to increase their awareness of these differences. This Intended Use Plan (IUP) will focus from this point forward on the Drinking Water Revolving Fund.

Michigan's DWRF program is available to qualified water suppliers to finance construction of their waterworks system projects. These may include, but are not limited to new wells, new water treatment plants, storage facilities, upgrades or expansions, transmission lines, pumping facilities, and other related waterworks system improvements. Suppliers must meet Federal and State program requirements, as well as demonstrate their ability to publicly finance their project.

The DWRF is a State-managed program. This FY1997/98 IUP describes how the DEQ and the Authority will jointly administer the DWRF during FY1997/98. The Municipal Facilities Section (MFS) of the Environmental Assistance Division (EAD) is charged with carrying out the program administration responsibilities. The Drinking Water and Radiological Protection Division (DWRPD) will assess project priority, issue necessary State permits, and offer technical assistance throughout the project planning, design, and construction phases. Financial administration of the program will be handled by the staff of the Authority. The administrative contacts for the DWRF are:

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The EPA-Region 5 will offer guidance and conduct annual program oversight reviews to strengthen the management of the DWRF and help to ensure consistent application of Federal requirements. The EPA serves as a helpful partner in creating and maintaining this program.

The relationship between the DEQ, the Authority, and the EPA is established in an Operating Agreement signed by authorized signatories from each agency. The Operating Agreement is incorporated into this IUP by reference and is available from the DEQ upon request.

At this time, project funding is not included. A revision to the IUP will occur in the early part of 1998 to add the component discussing specific project funding and the Project Priority List (PPL). It will also undergo a public participation process at that time.

The DEQ certifies that it is recognized by the EPA as the primary agency for management of the drinking water program. The priority system was developed and will be carried out each fiscal year by staff of the DWRPD. The DWRF will not be as heavily capitalized as the SRF and we must first provide assistance to those projects which will have the greatest impact in facilitating safe drinking water supplies. It is important to ensure that the technical expertise developed by this staff will be used to assess project priorities.

II. STRUCTURE OF THE DWRF

It is the State's intent to operate the DWRF within a financing structure similar to the SRF. For water suppliers who are municipalities with bonding authority, this presents no significant challenges. The DWRF will sell tax-exempt revenue bonds to provide money which will be used to reimburse communities for incurred costs. As the DWRF reimburses suppliers, federal funds from the capitalization grant and state funds from the grant match will be transferred into a debt service reserve account to provide coverage for the leveraged bond issue.

However, for water suppliers who are private entities, clarification of the private activity rulings for tax-exempt issues is necessary. Loans from the DWRF will be offered under Part 54, 1994 PA 451 to private water suppliers who meet all other criteria for receiving funds. At this time, the DEQ and the Authority plan to fund private water suppliers from money drawn directly into the DWRF. This would avoid contamination of the tax-exempt bond issue.

The schematic design of the flow of funds is included in the Operating Agreement.

One of the major differences between the SRF and the DWRF is the use of set-aside funds. The set-asides in the DWRF are derived from the overall capitalization grant awarded to the State by the EPA. Legal provisions now included in 1985 PA 227 permit the Authority to establish accounts and sub-accounts within the DWRF to track revenues and expenditures for the set-asides. The set-asides for program and other activities will be directly administered by the DWRPD. Staff of the DWRPD will also be responsible for the technical assistance activities, except for those funds made available to forgive loans to disadvantaged communities. The administrative set-aside will be managed by the MFS.

The following is a list of potential set-asides identified in Section 1452 of the Federal Safe Drinking Water Act:

DWRF Administration 4 percent

Technical Assistance 2 percent

Program Set-asides 10 percent

Public Water System Supervision

Source Water Protection

Capacity Development

Operator Certification

Other Activities 15 percent, not to exceed 10 percent for any one activity

Loans for Source Water Protection

Assistance for Capacity Development

Source Water Assessment

Implement Wellhead Protection

It is imperative to note that the program set-asides require a one-for-one State match, in addition to the regular 20 percent State match calculated on the entire amount of the federal capitalization grant. Thus, money diverted to these set-asides will demand a heavier investment of State or local funds.

III. ADVANTAGES OF THE DWRF

The primary advantage for Michigan water suppliers will be their ability to borrow funds at rates well below market. The DWRF interest rate is established prior to each new fiscal year. As identified in Part 54, 1994 PA 451, determination of the interest rate is based on demand, market conditions, program costs, and future needs. Since a portion of the State match in any given fiscal year may be financed with State Revenue Match bonds, the upcoming year's interest rate must also account for the expense incurred in securing these bonds. After considering the variables listed in Part 54, the DEQ director will set a rate of interest for FY1997/98.

Apart from the low interest rate, suppliers also benefit from the DWRF in that they can finance all eligible waterworks system costs. They often do not have to seek other sources or enter the market to obtain local share financing. Everything is handled by this "one-stop shopping" concept.

The major benefit simply results from the fact that water supply financing in the past has always been left to the local units of government or private entities. There has been no significant State assistance in the past to assist local officials in meeting water supply needs. This DWRF will provide an on-going source of funding to maintain or improve drinking water quality and public health.

IV. LONG-TERM GOALS

Michigan's DWRF establishes a new funding source designed to protect and preserve public and environmental health within the State's boundaries. Michigan's geographical identity as a Great Lakes State affords its citizens with an abundant and high quality water resource from which to draw its drinking water. Unlike many western states, Michigan water supplies are plentiful and periods of restricted use are few and far between in most communities.

Given our abundant water resource, the greater challenge for water suppliers lies in protecting the high quality of the resource as well as ensuring that adequate volume and pressure exist to deliver potable water to the end customer.

Given the limitations on pooled capital, the DEQ will work toward establishing

tighter integration of the Federal/State/local partnership. As a step of good faith effort, the DEQ is beginning to examine ways to work together with various Federal and State agencies, such as the Rural Utility Service, Housing and Urban Development, and the Michigan Jobs Commission, so that we may collectively fund applicants and maximize use of our capital pool and achieve our stated goals.

Such partnerships will ultimately benefit everyone. Industry, tourism, and day-to-day quality of life are strengthened when our most valuable natural asset is preserved and made available for our use and enjoyment. To this end, Michigan's DWRF seeks the following:

To achieve and maintain statewide compliance with all applicable State and Federal drinking water laws, rules and standards.

To protect the public health and environmental quality of our State.

To develop and commence a source water assessment and a wellhead protection program.

To develop strategies within the DWRF to assist smaller, hardship communities in meeting drinking water standards.

To promote the DWRF as a viable tool for use by Michigan water suppliers in financing their waterworks system improvements or upgrades.

To secure Michigan's full share of Federal funding and to expeditiously obligate these moneys, along with the State contributions, for the construction of eligible activities which meet State and Federal requirements.

To develop effective partnerships with other Federal and State financing sources to promote efficiency in environmental review procedures and funding coordination.

**V.
SHORT-TERM
GOALS**

In order to accomplish the long-term goals, we must also focus on more immediate objectives. Therefore, for our short-term goals in FY1997/98, we will strive:

To develop the following:

Project Planning Guidance (targeted for September 1, 1997)

Eligibility Guidance (targeted for September 1, 1997)

Disadvantaged Community Guidance (targeted for September 1, 1997)

User Charge System Guidance (targeted for November 1, 1997)

Application and Guidance (targeted for November 1, 1997)

To prepare and sign the following before September 30, 1997:

Intra-agency Agreement between the Environmental Assistance Division and the Drinking Water and Radiological Protection Division

Interagency Agreement between the Michigan Department of Environmental Quality and the Michigan Municipal Bond Authority

Operating Agreement between the EPA-Region V, the Michigan Department of Environmental Quality, and the Michigan Municipal Bond Authority

To prepare an outreach effort to publicize the DWRF through direct mail, electronic media, newsletter publication, workshops and direct meetings.

To promote the small community hardship assistance.

To staff up and develop implementation plans for source water protection focused on state-wide surface water assessments and ground water assessments in areas tributary to the Great Lakes.

To enhance the State's wellhead protection program.

To identify and establish a technical assistance program for small communities.

To fund those projects identified later in the revised IUP, enabling them to proceed with construction of facilities included in their adopted project plans during the third and fourth quarters of FY1998.

VI. ALLOCATION OF FUNDS

Allocation of funds among eligible uses is based on a three-step process. First, the DEQ identifies the sources of funds and the spending limits for the DWRF within the given fiscal year. Next, a determination of the type and amount of financial assistance necessary for each supplier is made. Finally, funds are allocated among the projects consistent with amounts available and the projects' priority standing. The allocations for project funding will not occur until we receive the capitalization grant dedicated to making loans.

The following information reflects the estimated sources of funds for FY1997 and FY1998:

For FY1997:

FY1997 Title IX Funds \$59,681,100

FY1997 State Match \$11,936,220

Anticipated Earnings 0

Released Funds (from Debt Service Reserve) 0

Repayments of Principal to DWRF 0

Repayments of Interest to DWRF 0

Total Sources of Funds for FY1997 \$71,617,320

For FY1998:

FY1998 Title IX Funds \$20,951,400

FY1998 State Match (Regular) \$ 4,190,280

FY1998 Program Set-aside Match \$ 875,000

Anticipated Earnings \$ 1,050,000

Released Funds (from Debt Service Reserve) 0

Repayments of Principal to DWRF 0

Repayments of Interest to DWRF 0

Total Sources of Funds for FY1998 \$27,066,680

For FY1997, Michigan's DWRF will seek to capitalize set-asides for administration, small community technical assistance, and source water assessments. Of the \$59,681,100 available from Federal capitalization of the DWRF, Michigan will reserve the following set-asides:

DWRF Administration \$2,387,244

Technical Assistance \$1,193,622

Source Water Assessment \$5,968,110

These total \$9,548,796 and will be requested by the DEQ in a capitalization grant application filed prior to the end of FY1997. This will leave a balance to be drawn for projects amounting to \$50,132,124. The grant application for this amount will not be submitted until late in the second quarter of FY1998. The first loans for projects are expected to be available in the third quarter.

The State match for the FY1997 capitalization grant will be \$11,936,220. Since no program set-asides will be used, there is no additional one-for-one match requirement. When added to the amount of the Federal share for project financing, the DWRF should have a total of \$62,068,344 available for project loans.

The DEQ and the Authority expect reimbursement for development costs incurred from August 6, 1996 to the date of the first capitalization grant award. This will be drawn upon grant award.

For FY1998, the Federal appropriation for DWRFs across the nation is targeted for \$725 million, according to the budget submitted by the President. This

amount provides Michigan's DWRF with \$20,951,400. This reduced amount, when compared against FY1997 figures, is the result of two factors. First, money originally appropriated for FY1996 was added to the FY1997 budget when the Federal Safe Drinking Water Act was not reauthorized within the prescribed time period. Secondly, the allotment formula changed as a result of the reauthorization. Michigan dropped from 4.75 percent of available funds in FY1997 to 2.94 percent in FY1998. This ranks eighth among all the states. Michigan's percentage of total need, as reflected in the national needs survey, is approximately 3.2 percent.

For FY1998, the DEQ intends to set-aside the following amounts in conformity with sections 1452(g)(2) and 1452(k) of the Federal Safe Drinking Water Act:

DWRF Administration \$ 838,056

Technical Assistance 419,028

Public Water System Supervision 0

PROGRAM SET-ASIDES (TOTAL \$875,000)

Source Water Protection 225,000

Capacity Development 450,000

Operator Certification 200,000

Wellhead Protection 1,000,000

The total set-asides for FY1998 will equal \$3,132,084. This leaves \$17,819,316 from the Federal capitalization funds available for project loans. The 20 percent State match will amount to \$4,190,280. The one-for-one additional State match (in cash or in-kind contribution) for program set-asides will equal \$875,000. Federal law permits half of this match to be counted from amounts expended by the State for public water supply supervision (PWSS) in FY1993. The remaining program set-aside match will be provided by the State funding sources for the PWSS program in FY1998. A total of \$22,009,596 will be available in FY1998 for project loans.

The DEQ does not expect the Governor to exercise his authority to transfer any moneys between the SRF and the DWRF during the period covered by this IUP.

VII. CRITERIA AND METHOD FOR DISTRIBUTION OF FUNDS

The DEQ has established the percentages for using the set-asides based on what it believes is implementable within the fiscal years addressed by this IUP. The split of moneys is structured to meet not only expected needs (i.e. 4 percent for administration), but also targeted programs to help suppliers prepare themselves to qualify for DWRF loans (technical assistance funds used to forgive planning loans).

Unlike the Clean Water SRF where there was history of need to fall back on, the DWRF is new for all members of the federal/state/local partnership. DEQ has taken effort to conservatively identify set-asides during these initial years to avoid over-commitment while the new program is in the "shake down" period. To accomplish this, the State proposes the following breakdown for FY1997 and 1998.

FY1997 Proposed Set-Asides - 16 Percent Total

4 Percent Administration

2 Percent Technical Assistance

The 2 percent Technical Assistance set-aside for FY1997 amounts to \$1,193,622. None of these funds will be spent in FY1997.

Beginning in FY1998, the DEQ will contract with technical service providers for various types of technical assistance to public water suppliers serving a population less than 10,000. The technical assistance will include operator training, direct on-site technical assistance for system operation, and assistance with documents and procedures to apply for DWRF assistance. The projected

amount is \$175,000.

The DEQ will also use technical assistance set-aside funds to the extent funds are available, to forgive loans to disadvantaged communities with less than 10,000 people who apply for DWRF assistance and have incurred project planning costs. The projected amount is \$1,018,622.

The administration and technical assistance set-asides taken from the FY1997 capitalization grant will not be used during FY1997 because of the timing of the grant award. These funds will carry over and be combined with FY1998 set-aside funds for reimbursements expected in FY1998.

10 Percent Source Water Assessment

The 10 percent Source Water Assessment set-aside for Fiscal Year 1997 amounts to \$5,964,000. None of these funds will be spent in FY1997.

Beginning in FY1998, the DEQ will hire staff and establish contracts for implementing a statewide Source Water Assessment Program. The projected amount is \$1,100,000. The remaining Source Water Assessment funds will be used in FY1999, 2000, and 2001 to complete the program.

Michigan is in the process of establishing the strategy for a statewide Source Water Assessment program. Federal guidance has just been issued and state staff have been participating in national meetings to discuss and consider alternatives. Michigan is also preparing a preliminary White Paper for distribution to EPA offices. The Michigan Source Water Assessment program will have to be submitted and approved by the EPA in accordance with the federal Safe Drinking Water Act.

The Michigan Source Water Assessment program will have to address over 10,000 non-community public water supplies in addition to the estimated 1,500 community public water supplies. Recognizing the scope of this task, the program will have to be specific to Michigan needs, establishing clear priorities for the work to allow completion within the allowable time and with the

available resources. Michigan has a strong commitment to a Source Water Assessment program strategy which benefits all users of water resources, both public and private.

FY1998 Proposed Set-Asides - 14.9 Percent Total

4 Percent Administration

2 Percent Technical Assistance

The same activities described for use of the FY1997 technical assistance set-aside will be used in FY1998. The total projected amount for the FY1998 set-asides is \$419,028. Combined with amounts carried over from FY1997, the total available for use during FY1998 totals \$1,612,650.

Program Set-Asides - 4.2 Percent

The DEQ intends to begin two new programs and provide expansion of an existing program in FY1998 using three program set-asides. The additional required matching funds will be provided through the PWSS program from State General Fund and Restricted Fund (Fee) revenue. Following is a breakdown of the \$875,000 projected amount:

Capacity Development - Through new staff and contracts, the initial elements of a state program will be identified, including public participation, and program options will be identified.

Capacity development means assessing the technical, financial, legal, institutional and managerial capability of public water supplies. The requirement to perform capacity assessments applies to DWRF applicants and to new community and non-transient non-community public water supplies.

Federal guidance will be used when available.
Administrative rules will be required. The scope of the

community development program will be identified. If procedures are proposed, they will be field tested at volunteer public water systems. The project amount is \$450,000.

Source Water Protection - Through new staff and contracts, the initial elements of a well abandonment program will be identified, including public participation, and program options will be identified. The state will use existing definitions and authority in the Michigan Safe Drinking Water Act and Public Health Code to implement this program.

Close cooperation with local health departments will be essential to coordinate the program with existing work now provided by local health departments through a 50/50 cost sharing agreement with the State. Abandoned wells represent a major threat to the groundwater resources of the State. The projected amount is \$225,000.

Operator Certification - The EAD will administer the program. The additional money will support new program activities to expand the scope of the existing operator certification program to include all community water supplies and non-transient non-community water supplies in accordance with expected new federal guidance. Operator training is also a part of this program. State administrative rule revisions will be required.

No new permanent staff have been authorized for this initiative in the state budget process. Therefore, money will be allocated by the DEQ to best meet program needs. Expected uses include limited term staff; updated computer systems for compliance tracking; development of new exams and procedures for non-community operators; and purchase of exam materials and grading services through third-party vendors. The projected amount is \$200,000.

Wellhead Protection (Section 1452(k))

The DEQ will initiate a Wellhead Protection Program enhancement involving matching grants to public water suppliers to provide additional incentive for local participation in the existing voluntary Wellhead Protection State Program. Wellhead protection training will be increased and educational materials developed for distribution to public water suppliers, local health departments, and the public. Administrative rules will be required. The projected amount is \$1,000,000.

State Staffing for Program Administration

The DEQ expects to receive authorization to add staff for implementation of the DWRF and the new initiatives funded through set-asides through the FY1998 state budget process as follows:

DWRF Administration - 4.0 FTEs for the Environmental Assistance Division

3.0 FTEs for the Drinking Water and Radiological Protection Division

Operator Certification - 0 FTEs for the Environmental Assistance Division

All other programs funded through set-asides, including technical assistance; source water assessments; source water protection (well abandonment); capacity development; wellhead protection - 7.0 FTEs for the Drinking Water and Radiological Protection Division.

VIII. EPA AUTOMATED CLEARING HOUSE ACTIVITIES

The EPA employs an Automated Clearing House (ACH) to make disbursements of Federal funds to the DWRF. Michigan will comply with this system and deposit funds drawn from it into appropriate accounts set up for the DWRF.

In FY1998, Michigan anticipates drawing FY1997 capitalization grant funds from the ACH according to the following schedule:

1st Quarter - \$1,750,000 Request processing in October, 1997

2nd Quarter - \$1,250,000 Request processing in February, 1998

3rd Quarter - \$3,000,000 Request processing in May, 1998

4th Quarter - \$3,548,796 Request processing in August, 1998

As project costs (or program administrative costs) are incurred, one request for disbursement may be submitted by the local project's authorized representative (or State agencies) each month. The request for disbursement of funds will be sent directly to the DEQ, who will then process the request as part of a weekly draw request. Upon delivery to its office, the Authority will execute the fund drawdown electronically by transferring money from the Federal ACH and State accounts. These amounts are drawn at 83.3 percent and 16.7 percent, respectively, except for program set-asides which may require different ratios. Where different ratios are required due to additional federal match requirements, the EPA and the state will agree to a negotiated fixed percent to simplify the draw process. Adjustments can be made annually to resolve differences in grant balances.

Moneys will be automatically deposited into the debt service reserve account of the DWRF, while funds are electronically wired to a municipal water supplier's bank from a DWRF account which holds funds from a taxable State issue. For private water suppliers, the funds will be transferred from direct Federal and State capitalization amounts established specifically for the purpose of reimbursing their eligible project costs.

IX. ASSURANCES

The final guidelines from the EPA set forth provisions that the State must provide certain assurances in order to qualify for capitalization grant funding. Such assurances are incorporated into the Operating Agreement and are included here by reference.

X. PUBLIC REVIEW AND COMMENT

In order to satisfy public participation requirements, the DEQ conducted a public hearing on the IUP and PPL. This year a public hearing to discuss the portion of the IUP dealing with the set-aside amounts took place July 22, 1997 at 1:30 p.m. in Lansing, Michigan. This hearing was announced in the Detroit Legal News, the Lansing State Journal, and the Marquette Mining Journal, posted on the DEQ calendar of events, listed on the MFS Internet site, and individually noticed to each water supplier on the proposed FY1997/1998 PPL. These sources adequately promoted the hearing to ensure maximum public input from those interested in the DWRF. This hearing afforded stakeholders and other interested parties an opportunity to hear and comment on how the DEQ plans to address the set-aside funds.

Questions about the public hearing responses or the final IUP may be directed to:

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XI. ORIGINATION OF DOCUMENTS

The Chief of the Municipal Facilities Section of the Department of Environmental Quality is responsible

for issuing the Intended Use Plan. The IUP and its accompanying information were prepared by Mr. Edward Moyer, Chief of the Technical Support Unit. It is a collaborative effort of DWRPD and EAD/MFS staff who provide data for its development. Questions specific to the structure or content of text or numbers, may be directed to Mr. Moyer's attention at the address listed above.

<http://www.deq.state.mi.us>

